

PART II

CURRENT DEVELOPMENTS

by

Toussaint Tyson and Thomas J. Miller

1. Announcements and News Releases

Ann. 96-92, 1996-38 I.R.B. 151 (Sept. 16, 1996)

This announces that beginning September 1, 1996, applications for recognition of tax exemption, formerly sent to key district offices in Atlanta, Georgia and Baltimore, Maryland, should be sent to: Internal Revenue Service, P.O. Box 192, Covington, KY 41012-0192.

Ann. 96-133, 1996-53 I.R.B. 60 (Dec. 30, 1996)

This announces that beginning January 1, 1997, applications for recognition of tax exemption, formerly sent to key district offices in Chicago, Illinois and Dallas, Texas, should be sent to: Internal Revenue Service, P.O. Box 192, Covington, KY 41012-0192.

Ann. 97-89, 1997-36 I.R.B. 10 (Sept. 3, 1997)

This announces that applications for recognition of tax exemption that were formerly sent to the Brooklyn KDO, should be sent to the Internal Revenue Service Center in Covington, Kentucky.

Ann. 97-115, 1997-47 I.R.B. 17 (Nov. 24, 1997)

This announces a proposal to modify the filing requirements for Form 990, Return of Organizations Exempt From Income Tax, and Form 990-EZ, Short Form Return of Organization Exempt From Income Tax, by raising the filing threshold. The Service sought the comments of interested parties on such modification as well as comments on how to reduce the burden on tax-exempt organizations while recognizing the continuing need for information as to the existence and operations of such organizations.

Ann. 98-42, 1998-21 I.R.B. 93 (May 26, 1998)

This announces that Pub. 3079, Gaming Publication for Tax-Exempt Organizations, is available. Pub. 3079 may be obtained by calling 1-800-TAX FORM or through the Internet at <ftp.fedworld.gov/pub/irs-pdf/p3079.pdf>. The publication may also be obtained through the Exempt Organization's Home Page at www.irs.ustreas.gov/bus_info/eo.

IR-97-19 (Apr. 3, 1997)

This news release cautions the public on abusive trusts used to improperly reduce or eliminate taxes while allowing the owner to retain full benefit from the assets held in such trusts. The news release clarifies that the Service will assess taxes and penalties against the participants and promoters of trusts found abusive, and will seek criminal charges where warranted. Notice 97-24, discussed below, is related to this information release.

IR-97-29 (Apr. 15, 1997)

This news release informs the public that Pub. 78 is now listed on the Service's website at <http://www.irs.ustreas.gov>. The listing is accessible through the "Tax Information for You" and "Tax Information for Business" sections of the page.

IR-97-50 (Dec. 31, 1997)

This news release concerns a Wall Street Journal article on the closing agreement entered into with the Church of Scientology.

2. Notices, Revenue Procedures and Revenue Rulings

Notice 96-46, 1996-2 C.B. 212

This notice describes the excise taxes imposed by IRC 4958 on excess benefit transactions engaged in between certain exempt organizations and disqualified persons and requests comments concerning problems to be addressed in proposed regulations.

Notice 96-47, 1996-2 C.B. 213

This notice describes the amendment to IRC 501(c)(4), which amendment expressly prohibits inurement of any part of the net earnings of an entity otherwise described in that section to the benefit of any private shareholder or individual.

Notice 96-48, 1996-2 C.B. 214

This notice describes disclosure requirements for, and increases of certain penalties on, tax-exempt organizations. See topic L of this CPE, for more information.

Notice 96-58, 1996-2 C.B. 226

This notice provides guidance regarding certain reporting requirements and the transition rules applicable to “qualified State tuition programs” described in IRC 529. The notice also invited comments on IRC 529, from the public, which comments will be considered in drafting future guidance.

Notice 96-68, 1996-2 C.B. 236

This notice provides guidance regarding certain definitions, i.e., “graduate level course” and “courses beginning” affecting the proper tax treatment of educational assistance received by employees under IRC 127.

Notice 97-24, 1997-1 C.B. 409

This notice alerted the public about certain trust arrangements that purport to reduce or eliminate federal taxes in ways that are not permitted by federal tax law. The notice describes five typical abusive trust arrangements, as well as the tax benefits promised by promoters, and then explains the correct tax principles that apply to these trust arrangements; these arrangements include the business trust, the equipment or service trust, the family residence trust, the charitable trust, and the final trust. The notice clarifies that abusive trust arrangements will not produce the tax benefits advertised by their promoters and that the Service is actively examining these types of trust arrangements. Additionally, in appropriate circumstances, taxpayers and/or promoters in these arrangements may be subject to civil and/or criminal penalties. IR-97-19, mentioned above, is related.

Notice 97-52, 1997-38 I.R.B. 20 (Sept. 22, 1997)

This notice extends the relief, available under Notice 96-58, 1996-2 C.B. 215, from the reporting requirements applicable to organizations described in IRC 529, which provides tax exempt status to qualified State tuition programs (STP's). Under Notice 97-52, the relief is available through 1998.

Notice 97-68, 1997-48 I.R.B. 11 (Dec. 1, 1997)

This notified interested taxpayers that the rules in sections 1.664-2(a)(1)(I) and 1.664-3(a)(1)(I)(e) of the proposed Income Tax Regulations, published in Reg.-209823, 1997-2, 62 Fed. Reg. 19072, will not be effective for certain charitable trusts for the 1997 taxable year. The underlying proposed regulation is discussed more fully at Part 3 of this article.

Rev. Proc. 96-40, 1996-2 C.B. 301

This revenue procedure modifies Rev. Proc. 80-27, 1980-1 C.B. 677, by identifying one central location, Ogden, Utah, where all filers of reports required of group parents to maintain group exemptions should send the required annual reports. The reports should be sent to Ogden Service Center, Mail Stop 6271, 1000 South 1200 West, Ogden, UT 84404-4749.

Rev. Proc. 96-59, 1996-2 C.B. 392

This notice provides 1997 cost-of-living adjustment factors and their applications to several items that use this adjustment method including: the IRC 512(d)(1) treatment of dues paid to agricultural or horticultural organizations described in IRC 501(c)(5); the “\$25 limitation” and “\$50 limitation” of IRC 513(h) (concerning the definition of the term “low cost article”); as well as other applications.

Rev. Proc. 97-12, 1997-1 C.B. 121

This revenue procedure modifies and amplifies Rev. Proc. 95-21, 1995-1 C.B. 686, which establishes when associate member dues payments received by organizations described in IRC 501(c)(5) will be treated as gross income derived from the conduct of an unrelated trade or business under IRC 512. Rev. Proc. 97-12 implements section 1115 of the Small Business Job Protection Act of 1996, P.L. 104-188, 110 Stat. 1755 which amended IRC 512 as it applied to the treatment of dues paid to agricultural or horticultural organizations described in IRC 501(c)(5).

Rev. Proc. 98-19, 1998-7 I.R.B. 30

For certain organizations exempt from federal income taxation under IRC 501(a), this revenue procedure provides guidance on certain exceptions from the IRC 6033(e) reporting and notice requirements regarding certain dues that are paid to these organizations and that are allocable to lobbying expenses. It also provides guidance on the tax imposed by IRC 6033(e)(2) on the organization for noncompliance with the IRC 6033(e)(1) notice requirement. This revenue procedure also updates and supersedes Rev. Proc. 95-35, 1995-2 C.B. 391, as modified by Rev. Proc. 95-35A, 1995-2 C.B. 392.

Rev. Rul. 96-41, 1996-2 C.B. 8

This revenue ruling uses two situations to provide guidance on the issue of whether a plan fails to qualify as an educational assistance program described in IRC 127(b) if the plan provides benefits to individuals after their employment has terminated. In Situation (1), the

former employees had voluntarily terminated (e.g., by retirement) their employment. In Situation (2), the former employees had been subject to “downsizing,” and had been involuntarily terminated from employment. In neither case did the plan fail to qualify under IRC 127(b).

Rev. Rul. 97-21, 1997-1 C.B. 651

This revenue ruling provides five examples illustrating whether a nonprofit hospital that provides incentives to physicians to join their medical staffs or to provide medical services in the community violates the requirements for exemption of organizations described in IRC 501(c)(3). In four situations the hospitals’ physician recruitment practices furthered the organization’s exempt purposes. In situation 5, the hospital’s physician recruitment practices violated federal law and are ruled inconsistent with charitable purposes.

Rev. Rul. 98-15, 1998-12 I.R.B. 6 (Mar. 23, 1998)

This ruling provides two examples illustrating whether nonprofit hospitals that participate in joint ventures with for profit entities continue to qualify for exemption under IRC 501(c)(3). In situation (1) the nonprofit organization retained its exemption status where the joint venture operated for exclusively charitable purposes. In situation (2), the nonprofit organization’s lack of control over the joint venture’s operations calls into question whether the joint venture will serve charitable purposes; this lack of control is fatal to exemption.

3. Regulations

Reg. 209121-89, 1997-1 C.B. 719, 62 Fed. Reg. 2064

This proposed regulation adds Prop. Reg. 1.337(d)-4 to the regulations implementing IRC 337 (concerning any taxable corporation that transfers all or substantially all of its assets to a tax-exempt entity or converts from a taxable corporation to a tax-exempt entity) and requires certain taxable corporations to recognize gain or loss in certain IRC 337 transactions.

Reg-209823-96, 1997-1 C.B. 763, 62 Fed. Reg. 19072

This transmits proposed amendments to the regulations under IRC 664 relating to charitable remainder trusts, both charitable remainder unitrusts and charitable remainder annuity trusts, and IRC 2702 relating to special valuation rules for transfers of interests in trusts. The proposed amendments contain rules on the conditions under which the governing instrument may provide a change in the method of calculating the unitrust amount, the date by which the annuity amount or the unitrust amount under the fixed percentage method must

be paid to the recipient, who is required to value unmarketable assets, and when IRC 2702 applies to certain charitable remainder unitrusts. See Notice 97-68, 1997-48 I.R.B. 11, for the effective date.

Reg. 246250, 1997-42 I.R.B. 30, 62 Fed. Reg. 50533

This proposed regulation relates to the public disclosure requirements of IRC 6104(e). The proposed regulation announced that public hearings would be held on February 4, 1998, and clarified that the amendments to IRC 6104(e) by Taxpayer Bill of Rights 2, P.L. 104-168, 110 Stat. 1452, would not become effective until 60 days after issuance of final regulations. See topic L of this CPE.

Reg. 121268-97, 1998-20 I.R.B. 12, 63 Fed. Reg. 20156

This transmits Prop. Reg. 1.513-7, augmenting existing guidance on the unrelated business taxable income aspect of travel tours, and clarifies when such tours are substantially related to the exempt organization's exempt purposes.

T.D. 8680, 1996-2 C.B. 194

Temporary, and proposed regulations (under IA-29-96), issued extending the time for making certain elections under the Code, and modifying Rev. Proc. 87-32, 1987-2 C.B. 396, (concerning extensions applicable to requests to change accounting methods), and Rev. Proc. 92-20, 1992-1 C.B. 685, (concerning extensions applicable to requests to change accounting methods). Additionally, T.D. 8680 continues the automatic six-month and twelve month extensions granted by Rev. Proc. 92-85, 1992-2 C.B. 490. This temporary regulation also continues relief provided by Rev. Proc. 92-85 for certain regulatory elections that do not qualify for relief under the six and twelve month automatic extension provisions. Additionally, the temporary regulation obsoletes Rev. Proc. 92-85 as of June 27, 1996.

T.D. 8690, 1997-1 C.B. 68

This treasury decision contains final regulations: Reg. 1.170A-1, providing guidance regarding the allowance of certain charitable deductions; Reg. 1.170A-13, which clarifies the substantiation requirements for charitable contributions of \$250, or more; and Reg. 1.6115-1, which provides the disclosure requirements for quid pro quo contributions in excess of \$75. The regulations affect both organizations described in IRC 170(c), and individuals and entities that make payments to such organizations.

T.D. 8705, 1997-1 C.B. 195

This treasury decision transmits final regulation, Reg. 53.6071-1T, providing that disqualified persons and organization managers liable for IRC 4958 excise taxes are required to file the Form 4720. The regulations also specify the filing date for returns for the period to which the IRC 4958 excise taxes retroactively apply. Temporary regulations, Reg-247862, 1997-8 I.R.B. 32, were also issued.

T.D. 8719, 1997-1 C.B. 100, 62 Fed. Reg. 27496

Temporary, and proposed regulations (under Reg. 209837-96 and Reg. 105299-97) issued on the procedure for requesting a change in accounting method and on the standards for granting an extension of time to request a change in accounting methods.

T.D. 8726, 1997-34 I.R.B. 7, 62 Fed. Reg. 40447

This treasury decision interprets IRC 401(a) and IRC 501(c)(5) and provides guidance on organizations seeking exemption under IRC 501(c)(5) where such organization's principal activity is to receive, hold, invest, disburse, or otherwise manage funds associated with savings or investment plans or programs, including pension or other retirement savings plans.

T.D. 8736, 1997-50 I.R.B. 5, 62 Fed. Reg. 52256

This promulgates Reg. 53.6071-1 clarifying the filing date for the Form 4720, which must be filed by disqualified persons and organization managers liable for the IRC 4958 excise taxes that are imposed on certain excess benefit transactions. See also T.D. 8705, which adds Reg. 53.6071T.

T.D. 8742, 1998-5 I.R.B. 4, 62 Fed. Reg. 68167

These final regulations provide procedures for requesting an extension of time to make certain elections under the Code. This T.D. 8742 applies to all Forms 3115 filed on or after December 31, 1997. T.D. 8680 (discussed above) and T.D. 8719 (discussed above) are related to T.D. 8742.

4. Court Decisions

A. Exemption Cases

Stichting Pensioenfonds Voor de Gezondheid, Geestelijke en Maatschappelijke Belangen v. United States of America, 950 F.Supp. 373 (D.D.C 1996)

The Fund was formed in 1969, and under its articles of association, control of the Funds was held by a Board of Directors. The twelve member board was comprised of six members selected by the three principal employer organizations and six members selected by the three principal unions representing certain employees. The union did not have control of the Fund. The District Court decided, on summary judgement, that the Fund was not described in section 501(c)(5), and specifically repudiated the analysis and conclusion of Morganbesser.

The District Court relied on the regulations, which describes IRC 501(c)(5) organizations as those that:

- (1) have no net earnings inuring the benefit of any member,
and
- (2) have as their objects the betterment of considerations of those engaged in such pursuits, the improvement of the grade of their products, **and** the development of a higher degree of efficiency in their respective occupations.

The court found that while traditional labor unions unambiguously meet such description, non-union entities must be controlled and funded by an exempt labor union. As the Fund was not so controlled or funded, it is not described in section 501(c)(5). The District Court also determined, consistent with the Morganbesser dissent, that recognizing pension plans as exempt under section 501(c)(5) jeopardized the ERISA regime.

Stichting Pensioenfonds Voor de Gezondheid, Geestelijke en Maatschappelijke Belangen v. United States of America, 129 F.3d 195 (D.C. Cir. 1997), *aff'd* 950 F.Supp. 373 (D.D.C. 1996)

The court affirmed the lower court's opinion, spending more analytical effort on distinguishing the taxpayer from those in the 15 revenue rulings concerning the exemption of organizations that claim exemption under IRC 501(c)(5). The court also criticized Morganbesser as being decided on the basis of non-precedential internal memoranda.

The taxpayer, invoking IBM v. United States, 343 F.2d 914 (Ct. Cl. 1965) (often used by taxpayers for the proposition that similarly situated competitors should be treated similarly by the Service) also claimed the Commissioner abused her discretion under IRC 7805. The court, noting that Pensioenfond had not shown the Service treated Pensioenfond dissimilarly from one of its competitors, rejected Pensioenfond's argument.

Golden Belt Telephone Ass'n v. Commissioner, 108 T.C. 498 (1997), *acq.* AOD 2256 (May 4, 1998)

Golden Belt, a telephone cooperative, received some of its income from non-member telephone companies as compensation for providing billing and collection services to such companies. The IRS determined these amounts were nonmember income that are from a nonmember telephone company for the performance of communication services; accordingly, the IRS revoked the organization's exemption. The Tax Court, relying on a Federal Communication Commission interpretation of the term "communication service," ruled a local telephone company's billing and collection service is the provision of communications services. Accordingly, the Tax Court decided that these amounts were improperly used to decide whether 15 percent (or more) of the cooperatives income is from nonmember income, and that the organization was described in IRC 501(c)(12). Such income is to be ignored (i.e., treated neutrally) when determining member and nonmember income.

KJ's Fund Raisers, Inc. v. Commissioner, 74 T.C.M. (CCH) 669 (1997)

The Tax Court ruled KJ's Fund Raisers, Inc. is not described in IRC 501(c)(3). The organization raised funds, through the sale of lottery tickets, on the site of a lounge, viz., KJ's Place. The Tax Court found that the lounge's owners controlled the organization and that the organization was operated for the substantial private benefit of KJ's Place and its owners.

The Fund for Anonymous Gifts v. Internal Revenue Service, 97-2 U.S.T.C. para. 50,710 (D.D.C. 1997)

The U.S. District Court for the District of Columbia ruled The Fund for Anonymous Gifts was operated for the private benefit of the donors, who made donor-directed donations to the Fund. The court distinguished the Fund from the successful taxpayer in National Foundation Inc. V. United States, 13 Cl. Ct. 486 (1987), where the Foundation agreed to accept a donor directed donation **after** the Foundation made an independent determination that fulfillment of the direction would further the Foundation's specific charitable program.

United Cancer Council v. Commissioner, 109 T.C. No. 17 (1997)

The Tax Court upheld the Service's revocation of recognition of United Cancer Council's exempt status under IRC 501(c)(3). The United Cancer Council entered into a five year mail solicitation fund-raising contract with a partnership, Watson & Hughey. UCC had no risk under the contract if the fund-raising went poorly, and enjoyed income if the fund-raising was successful. UCC paid very high rates for the creation of its mailing lists, which the court found were controlled by W&H during the term of the contract. Much of the compensation for the creation of the mailing lists was paid to W&H or one of its affiliates. Funds generated by the mail solicitations were deposited into an escrow account and were disbursed only on instructions from W&H. UCC was dependent on these funds to avoid insolvency. Even though the contract was amended from time to time, W&H did not, during

the contract term, release control of the mailing lists nor the escrowed funds. Upon expiration, the contract was not renewed.

The Service argued the UCC's net earnings inured to the benefit of W&H. The Tax Court agreed. The Tax Court found that W&H exercised substantial control over UCC finances and direct mail fund-raising campaigns, and, thus, found the W&H partners to be an insider. The Tax Court further determined that the compensation paid to W&H and its affiliates were not justified by the services, including risk of loss in the fund-raising campaign.

Variety Club Tent No. 6 Charities, Inc. v. Commissioner, 74 T.C.M. (CCH) 1485 (1997)

Variety Club Tent No. 6 Charities, Inc.'s (Variety) exemption, under IRC 501(C)(3), was revoked because of the Service's determination that Variety's net earnings inured to certain insiders. The organization raised funds, in part, through the operation of bingo games, which provided substantially all of the organization's income. Three men operated the games and criminally skimmed profits. Two of these men had formal roles with Variety and had been delegated considerable authority and duties concerning the bingo games. These men were also part owners in an entity that held the lease to the bingo games' site. Apparently the bingo sites were selected without competitive bidding. The illegal skimming was discovered by State authorities, who filed criminal charges against the three men. Variety paid some legal bills for one of them but such payment was inconsistent with Variety's compensation procedures.

The Tax Court ruled that the two who had positions with Variety were insiders as they held some formal and practical control over most of Variety's income. The Tax Court refused to find the theft, from the skimming operations, to be inurement. However, payment of legal fees to an insider against the exempt organization's compensation procedures resulted in inurement. Additionally, the Tax Court ruled Variety had failed to carry its burden of showing the rents paid for the bingo site was reasonable. These findings led the Tax Court to uphold the Service's retroactive revocation of Variety's exemption.

John F. Tupper, et al. v. United States of America, 98-1 U.S.T.C. para. 50,148 (1st Cir. 1998), *aff'd* 75 A.F.T.R.2d 1096 (D.C. Mass. 1995)

Two pension plans were set up with half of the trustees of each plan selected by labor and the other half selected by the employers. The plans were funded by the employers. Forms 5500 were filed for 1986, 1987 and 1988. The plans were found in non-compliance with ERISA. The plans then claimed exemption under IRC 501(c)(5) as labor organizations. The District Court of Massachusetts found for the Service, and was upheld on appeal. The First Circuit, using an analysis similar to that used in Stichting (see above) but expanding on the ERISA analysis, extends the Stichting ruling and isolates the Morganbesser ruling.

Leila G. Newhall Unitrust v. Commissioner, 105 F.3d 482 (9th Cir. 1997), *aff'g* 104 T.C. 236 (1995).

The Ninth Circuit affirmed the Tax Court's pro-Service ruling that an IRC 664(d)(2) charitable remainder unitrust (CRUT) is subject to the unrelated business income tax on all its income in the taxable year that such trust has any unrelated business taxable income. During the years at issue, 1988 and 1989, the taxpayer, a CRUT, held a limited partner interest in three publicly traded limited partnerships. The CRUT argued that it held no interests in IRC 512(c) partnerships, that the CRUT was not a member of the partnership, and that its income from the PTLP should not be treated as UBTI. None of these arguments dissuaded the court from literally interpreting IRC 512(c), which specifically considers all exempt organization's income from a PTLP to be UBTI. (IRC 512(c) has been significantly amended effective January 2, 1994.)

Tony and Susan Alamo Foundation v. Commissioner, 93 F.3d 1190 (8th Cir. 1996) *aff'g* 63 T.C.M. (CCH) 2422 (1992)

The Eighth Circuit affirmed the Tax Court's pro-Service ruling that the organization's recognition of exemption under IRC 501(c)(3) was not improperly retroactively revoked. The underlying case involved the inurement of the Foundation's net earnings to private parties.

B. Unrelated Trade or Business Cases

John W. Madden, Jr., et al. v. Commissioner, 74 T.C.M. (CCH) 440 (1997)

This case involved UBTI from rentals of a private foundation's space and liability for excise taxes under IRC 4941. The private foundation operated an outdoor museum that leased its adjacent office space and its amphitheater; and the private foundation provided security and parking services in connection with its amphitheater lease. The Tax Court ruled the leases of office space near the outdoor museum exposed such art to individuals who may not otherwise have seen the art; accordingly, these rentals furthered the private foundation's exempt purposes. However, the Tax Court upheld the IRS' determination regarding the lease payments from the amphitheater, which were not substantially related to the private foundation's exempt purpose. Additionally, as the private foundation provided substantial services in connection with this lease, the court ruled the IRC 512(b)(3) exclusion was unavailable.

Mr. Madden, an IRC 4946(a)(1) disqualified person with respect to the private foundation, held a 75% interest in a janitorial company that received fair market compensation for its services. The Tax Court ruled that as janitorial services are not the type of "personal services" excepted from the per se prohibited transactions rules, the janitorial

services company was liable for the IRC 4941(a)(1) excise tax. Additionally, clear and convincing evidence showed that Mr. Madden and other foundation managers, in their capacity as such, knew of the transactions, and of the janitorial company's disqualified person status to the private foundation, but had failed to obtain competent advice on whether the transactions were prohibited transactions; accordingly, the Tax Court upheld the Service's IRC 4941(a)(2) determinations that the foundation managers wilfully and knowingly participated in the prohibited transactions without reasonable cause. However, with respect to two payments to the janitorial company that the foundation managers lacked actual knowledge of, the Tax Court ruled such organization managers were not liable for the IRC 4941(a)(2) excise tax.

Leila G. Newhall Unitrust v. Commissioner, 105 F.3d 482 (9th Cir. 1997), *aff'g* 104 T.C. 236 (1995)

Discussed as an exemption case.

State Police Association of Massachusetts v. Commissioner, 125 F.3d 1 (1st Cir. 1997), *aff'g* 72 T.C.M. (CCH) 582 (1996)

The First Circuit upheld a favorable Tax Court ruling that the State Police Association of Massachusetts (Association) was properly assessed unrelated business income tax attributable to advertisements displayed in an annual yearbook. The Association serially used the services of two contractors that published the yearbook, and recruited and managed telemarketers of the yearbook's advertising space. The Association provided much supervision of the contractor's work. The Association argued that it did not operate a trade or business and that its activity was not conducted regularly. The court, relying on its own analysis and Fraternal Order of Police v. Commissioner, 833 F.2d 717 (7th Cir. 1987), agreed that the publishing of advertisements is a trade or business. Additionally, the court agreed with the Service's position that even though the Association used contractors, these contractors were mere agents of the Association; accordingly, the court agreed that the Association was engaged, through its agents, in the trade or business of advertising. Concerning the Association's regularity argument, the court, distinguishing National Collegiate Athletic Ass'n v. Commissioner, 914 F.2d 1417 (10th Cir. 1990), agreed with the Service that where the periodical "is not pegged to a particular event" then the relevant time of the activity is the time of solicitation of the advertisements, which in this case was approximately 46 weeks; this was, in the court's view, more than sufficient regularity by any standard.

Mississippi State University Alumni, Inc. v. Commissioner, 74 T.C.M. (CCH) 458 (1997)

The Tax Court ruled against the Service in an unrelated business income tax case involving the organization's participation in an affinity credit card arrangement, and the three year rental of its mailing list to one user. The Tax Court found that the organization's participation in the affinity card arrangement was "minimal and infrequent." Concerning the organization's rental of its mailing list, the court distinguished this case from Disabled Am. Veterans v. Commissioner, 942 F.2d 309 (6th Cir. 1991), where the organization regularly rented its mailing list. Rather, the Tax Court found that "[like] the taxpayer in Sierra Club, Inc. V. Commissioner, 86 F.3d 1526 (9th Cir. 1996), [the organization] maintained its mailing lists to further its tax-exempt function." In both cases, i.e., affinity card payments and mail list rental payments, the Tax Court found the payments to be nothing more than royalties, which are exempt from the unrelated business income tax.

Women of the Motion Picture Industry, et al. v. Commissioner, 74 T.C.M. (CCH) 1217 (1997)

This unrelated business income tax case involved five charitable organizations licensed, in Texas, to conduct bingo activities. Maintenance of the license required that the licensed organization maintain a "bingo account", which held gross bingo receipts minus winnings payouts. Funds in the "bingo account" could be used to pay expenses necessary to the conduct of the game and to make charitable disbursements. Under Texas law, the mere transfer of funds from the "bingo account" to the charitable organization's general account would be a permissible charitable disbursement.

In an effort to reduce their UBIT liability, the organizations claimed, as business deductions, under IRC 512(a) and IRC 162, amounts merely transferred from the "bingo account" to the general account. Additionally, one organization, which had made charitable payouts, claimed, under South End Italian Independent Club v. Commissioner, 87 T.C. 168 (1986), that it was entitled to an IRC 162 deduction for amounts so paid out.

The Tax Court ruled that those organizations that merely transferred funds from the "bingo account" to the organization's general account were unable to pass the all-events-test IRC 461 bar to IRC 162 deductions because there is no economic performance of the payment of a liability in the mere transfer of funds from one account to another - even if such transfer is statutorily required. Additionally, the Tax Court ruled that the fifth organization, which made actual charitable payouts and, therefore, passed the all-events-test, was entitled to the IRC 162 business deduction under South End Italian for the full amount of the charitable payouts.

Julius M. Israel, Lodge of B'nai B'rith No. 2113 v. Commissioner, 98 F.3d 190 (5th Cir. 1996), *aff'g* 70 T.C.M. (CCH) 673 (1995)

The Fifth Circuit affirmed the Tax Court's pro-Service ruling that taxpayer's "Instant Bingo" games do not qualify for the IRC 513(f) "bingo game" exception. In "Instant Bingo" the winning card is that in which the preprinted appearance of numbers matches the preprinted winning arrangements indicated on the card's reverse side. During the years at issue, 1987 through 1989, the taxpayer conducted its "Instant Bingo" games in full accord with local laws.

The Fifth Circuit ruled that the taxpayer's "Instant Bingo" was not a bingo within the meaning of Treas. Reg. Sec. 1.513-5(d) nor was it bingo within the more restrictive meaning of IRC 513(f).

American Academy of Family Physicians v. United States, 91 F.3d 1155 (8th Cir. 1996)

The Eighth Circuit affirmed the District Court's pro-Taxpayer ruling that the taxpayer's income derived from sponsorship of group insurance plans was not unrelated business taxable income. The taxpayer provided its mailing list, at fair market value, to its for-profit subsidiary, which administered the insurance plans. The insurance was underwritten by a third party insurance company. This insurance company was obligated to make certain payments to the taxpayer based on the reserves set aside to pay claims. During the years at issue, 1984 through 1987, the insurance company paid \$600,000 to the taxpayer, which the Service argued was fees for brokerage services supplied to the insurance company and, therefore, UBTI. The court, distinguishing United States v. American Bar Endowment, 477 U.S. 105 (1986) (here, the taxpayer, ABE, engaged in "clearly extensive" commercial activities), disagreed.

C. Chapter 42 Cases

John W. Madden, Jr., et al. v. Commissioner, 74 T.C.M. (CCH) 440 (1997)

Discussed as an unrelated business income tax case.

D. Disclosure

William J. Lehrfeld v. Richardson, 954 F.Supp. 9 (D.D.C. 1996), *aff'd* 132 F.3d 1463 (D.C. Cir. 1998)

The plaintiff filed a request for copies of an exemption application and supporting documents pertaining to an organization recognized as exempt from federal income tax. The Service complied with the request, but withheld certain documents, e.g., the Form 3198, Special Handling Notice and the Form 2362-A, Request for IDRS Input for BMF/EO Entity Change. The plaintiff sued; arguing he was entitled to these withheld documents under the

Freedom of Information Act or IRC 6104. The District Court, on summary judgement, held for the Service. The District Court determined that FOIA, under exemption 3, exempts from the FOIA those materials that under statute may not be disclosed, and that IRC 6103 is one such statute. (The withheld documents were ruled "return information" and IRC 6103 provides that "return information" is not discloseable.) Regarding disclosure of the withheld documents under IRC 6104, the District Court held that the 6104 regulations, which have the force of law, clarify that IRC 6104 only applies to "the tax-exempt application and the documents submitted by the organization seeking tax-exempt status." The withheld documents were not submitted by the organization; they were generated by the Service.

Branch Ministries, Inc. v. Richardson, 970 F.Supp. 11 (D.D.C. 1997)

Branch Ministries, Inc. challenged revocation of its exemption under IRC 501(c)(3). Part of the basis of the challenge was an allegation that the IRS used selective prosecution. To build its case, BMI sought discovery of information it believed was reasonably capable of supporting such basis. The Service argued the information sought was privileged from discovery or was discloseable under IRC 6103. In a very fact specific case, the District Court ruled against the IRS and granted much of BMI's discovery motion.

5. Bills and Legislation of the 105th Congress

H.R 2676, Internal Revenue Service Restructuring and Reform Act of 1998

Section 1001 would require the Commissioner to develop and implement an IRS reorganization plan that would eliminate or substantially modify the present system built on a national, regional and district structure in favor of organizational units serving particular groups of taxpayers. This provision also requires an independent appeals function.

Section 1101 would establish a nine member Internal Revenue Service Oversight Board; six of the members would be appointed by the President, with the advice and consent of the Senate; one member would be the Secretary of Treasury (or his Deputy); one member would be the Commissioner; and one member would be a representative of a substantial number of IRS employees. Generally, the Oversight Board would oversee IRS administration, management, conduct, direction and supervision of execution and application of the internal revenue laws. The Oversight Board is to have no responsibility for development and formulation of tax policy; nor responsibility for specific law enforcement activities.

The Office of Assistant Commissioner for Employee Plans and Exempt Organizations, as it is expressed in IRC 7802(b), would be eliminated.

This provision is effective upon enactment of this bill.

Section 1102(e)(3) would amend IRC 7611(f) to prohibit the beginning of a church tax inquiry or examination within five years of a prior church tax inquiry without the written consent of the Secretary of Treasury.

Section 3106 would amend IRC 7478 to expand the remedy of Tax Court review to the holders of prospective obligations. The bill would also require the issuer of any previously issued obligation to provide adequate notice that such issuer has filed an IRC 7478 action for declaratory judgment concerning the bond issuance. Generally, the effective date is upon enactment of the bill.

H.R. 2646, Parent and Student Account Plus Act

Section 104(a) would amend IRC 529 to make certain distributions from a qualified State tuition program tax-free to the extent such distributions do not exceed the designated beneficiary's qualified higher education expenses.

Section 104(b) would amend IRC 529(e)(3) to expand the definition of "qualified higher education expenses" to include "expenses for tuition, fees, academic tutoring, special needs services, books, supplies, computer equipment (including related software and services), and other equipment which are incurred in connection with the enrollment or attendance of the designated beneficiary at an eligible educational institution."

These provisions would be effective for taxable years beginning after December 31, 1998.

The **Taxpayer Relief Act**, P.L. 104-34, 111 Stat. 788, (the Act), enacted August 5, 1997, includes a number of provisions affecting exempt organizations.

Section 602 of the Act extended the IRC 170(e)(5) favorable tax treatment for appreciated stock donated to private foundations. The new termination date is June 30, 1998.

Section 101(c) of the Act amended IRC 501(c)(26) to allow a state-established, high-risk insurance pool to extend coverage to the qualifying children (as defined in new sec. 24(c)) of individuals (parents and spouses) who are described in IRC 501(c)(26)(B). Generally, these are individuals who cannot otherwise obtain inexpensive health insurance because of a pre-existing medical condition.

Section 963 of the Act amended IRC 501(c)(27) (state-established membership workers' compensation organizations) to expand the universe of organizations that qualify. Section 501(c)(27) now includes any organization: (1) created by and operated under state law to provide statutorily encouraged or required workers' compensation insurance and "related coverage which is incidental to [workers' compensation insurance];" (2) providing workers'

compensation insurance to any state-qualified employer in the state seeking such insurance; (3) to which the state makes a significant financial commitment and upon dissolution, the organization's assets reverts to the state; and (4) the majority of whose board (or oversight body) is selected by an element of the state's executive or legislature, or both. This amendment applies to taxable years beginning after December 31, 1997.

Section 974 of the Act amended IRC 501(e) to "clarify" that billing and collection services includes the purchase of patron accounts receivable on a recourse basis. This provision applies to taxable years beginning after December 31, 1996.

Section 1042 of the Act repealed the off-Code exception for TIAA-CREF from the effects of IRC 501(m), thus, repealing the IRC 501(c)(3) status of TIAA-CREF. This is effective for any taxable year beginning after December 31, 1997.

Section 1041 of the Act amended IRC 512(b)(13) to expand the IRC 512(b)(13) "look-through" rule to treat certain interest, rents, royalties or annuities paid to an exempt organization by its first or second tier subsidiary (or other entity, i.e., partnership or trust) as UBTI if the exempt organization's interest in the subsidiary (or other entity), by vote or value, exceeds 50 percent. Generally, the amendment applies to taxable years beginning after August 5, 1997. There is a two year grandfather provision for certain binding contracts that were in force on June 8, 1997.

Section 965 of the Act amended IRC 513 to "clarify" that the term "unrelated trade or business" does not include the activity of soliciting and receiving qualified sponsorship payments. Generally, the Act does not conflict with Prop. Reg. 1.513-4, except that it revokes the "tainting" rule with respect to payments that are made, at least in part, for advertising. The amendment provides for allocation of dual payments between the qualified sponsorship payment and the "other portion." The amendment applies to payments solicited or received after December 31, 1997.

Section 966 of the Act amended IRC 528 (homeowner associations) to include favorable tax treatment for holders of timeshare interests. This amendment applies to taxable years beginning after December 31, 1996.

Section 211 of the Act liberalized IRC 529 (qualified state tuition programs). Unless otherwise indicated, the amendments to IRC 529 became effective January 1, 1998. Some of the more important changes include:

The definition of "qualified higher education expenses" has been expanded to include room and board of students who are at least half-time. This amendment is effective as of August 20, **1996**.

The definition of "member of the family" has been expanded to the more liberal one provided by IRC 152(a)(1-8) and the spouse of any such person. This amendment is effective beginning January 1, 1998. However, there is a special grandfather provision for all pre-August 20, 1996, contracts that allow rollovers or change of designated beneficiary.

The Act makes an off-Code amendment to IRC 529(c)(3)(C) so that in the case of any pre-August 20, 1996, contract, an IRC 529(c)(3)(C) rollover or change of designated beneficiary may be made to an individual that is not a "member of the family."

The definition of "eligible educational institution" is expanded to include any institution described in 20 U.S.C. sec. 1088 if such institution is eligible to participate in a program under Title IV of the Higher Education Act of 1965. (Effectively, this means certain proprietary schools may be eligible educational institutions). This amendment applies to distributions after December 31, 1997, with respect to expenses paid after such date (in taxable years ending after such date), for education furnished in academic periods beginning after such date.

The IRC 529(d) reporting requirements are now enforced by the IRC 6693 \$50 per failure penalty.

The Act amended IRC 529 to make a completed gift (for the purposes of Chapters 12 and 13 of the Code) of any contribution to a qualified state tuition program. This rule applies even if the contract, under state property law, does not make a completed gift of such contribution. This amendment is effective after August 5, 1997.

Section 1089 of the Act amended IRC 664(d) (defining charitable remainder unitrusts and charitable remainder annuity trusts) to narrow the definition of charitable remainder trusts ("CRT") by:

- (a) proscribing annual payouts to the non-charitable interests exceeding 50 percent of the trusts assets; this provision applies to transfers made after June 18, 1997; and
- (b) requiring that the value of the charitable remainder be at least 10 percent of the FMV of the property transferred in trust on the day of the contribution to the CRT; this applies to transfers made after June 28, 1997.

Section 1603 of the Act amended IRC 4962 to clarify that the first tier Intermediate Sanctions excise tax is abatable, as appropriate. Section 1603 of the Act also made Intermediate Sanctions related changes to the IRC 6033 reporting requirement. Technically, these changes are to TBOR2, thus, the effective dates of these amendments are dictated by TBOR2.

Section 1461 of the Act amended IRC 6655(g)(3) and affects IRC 6655(I) to provide that a private foundation's first-quarter estimated tax payment is due on May 15th, or in the case of a fiscal year taxpayer, no later than the 15th day of the fifth month of the taxable year. (Ignoring extensions, this day is the due date of the exempt organization's annual return.) The amendment applies to taxable years beginning after August 5, 1997.

Section 4041(a) of the **Balanced Budget Act**, P.L. 105-33, enacted August 5, 1997, amended IRC 501(o) to provide that certain organizations, whose hospitals participate in provider-sponsored organizations, shall not fail to be treated as organized and operated exclusively for charitable purposes. Additionally, any person with a material interest in the provider-sponsored organization shall be treated as a private shareholder or individual with respect to the hospital.

6. Miscellaneous

Buckeye Countrymark v. Commissioner, 105 T.C. 547 (1994), *acq.* 1997-1 C.B. 1.